MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2018/2019

BBF3084 – GLOBAL FINANCE
(All sections/Groups)

13 OCTOBER 2018
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 4 pages with 1 Section only.
2. Answer **ALL** questions.
3. The distribution of the marks for each question is given at the end of each question.
4. Please write your answers in the Answer Booklet provided.

INSTRUCTION: ANSWER ALL QUESTIONS (100 MARKS)

QUESTION 1

The Future of the U.S.-China Trade War

By David Dollar
Monday, July, 2018

The Trump administration followed through today on a 25-percent tax on imports of $34 billion of goods from China, including machinery and components like semiconductors. A tax on another $16 billion of goods is in the works. China immediately retaliated with a 25-percent tariff on imports of soy beans, other agricultural products and automobiles. These moves come on top of tariffs already imposed on steel, aluminum, washing machines and solar panels.

The aggregate amount of trade affected is moderate relative to the U.S. and Chinese economies, but for the U.S., this is the most extensive import protection since the disastrous Smoot-Hawley tariffs in the 1930s. President Trump has threatened a 10-percent tax on a further $200 billion of imports from China. What is the effect on the two economies and where does this all end?

China is in a fairly good position to weather this storm. Its economy is less dependent on exports in general, and exports to the U.S. in particular, than just a decade earlier. The value added in its exports to the U.S. is less than 3 percent of its economy. Some of the pain from the U.S. tariffs will hit these other economies such as Canada, Mexico and the European Union not China. Countries are ranked by how integrated they are into the global value chain. The countries most at risk are those which supply raw materials to other countries, which then use those raw materials in the production of goods for export. Taiwan, South Korea, Singapore, and Ireland are all vulnerable. Still, the trade war comes at a bad moment in China's cycle.

In the past two months, the Chinese currency has depreciated 4.3 percent against the dollar. This is a natural market reaction to the U.S. protection. Over the same period, the dollar has appreciated about 5 percent against a basket of major currencies. Insta Ltd., a company in Czech Republic, a member of EU sold steel to Orime Ltd. in the United States on credit and invoiced $10 million payable in six months. Currently, the six-month forward exchange rate is $1.20/€ and Insta Ltd. predicts that the spot rate is likely to be $1.08/€ in six months. Among the hedging tool, forward contract, foreign exchange swap and cross-currency basis swap have been widely used.

Adapted from https://www.brookings.edu/blog/order-from-chaos/2018/07/09/the-future-of-the-u-s-china-trade-war/

a) Explain with **FOUR (4)** examples the possible effects of appreciation of Dollar on European companies' net profit in the steel and aluminum industry?

(20 marks)

Continued...

b. Distinguish between the term "foreign exchange swap" and "cross-currency basis swap".

(8 marks)

c. Estimate the expected gain/loss from the forward hedging for Insta Ltd. Based on your answer, would you recommend hedging this dollar receivable? Justify your answer with computation.

(8 marks)

d. Would you still recommend hedging in this case if the future spot rate is predicted to be the same as the forward exchange rate quoted today? Why or why not?

(4 marks)

(Total: 40 marks)

QUESTION 2

a. The Balance of Payment (BOP) data is undeniably important to both business managers and investors.
Define BOP. Assume that foreign investors have purchased a significant portion of Malaysia's government bond issues. How would the short term and long-term effects of foreigners' portfolio investment impact Malaysia's BOP? Discuss.

(10 marks)

b. One of the major trading partner for a company in Taiwan is a Singaporean company. This Taiwanese company has net receivables of 200,000 Singapore dollars in 360 days. The spot rate of the S$ is $0.75, and the Singapore interest rate is 3% over 360 days while United States (U.S.) interest rate is 4%. Provide suggestion on how this Taiwanese company implements a money market hedge with calculation.

(10 marks)

(Total: 20 marks)

Continued...

QUESTION 3

a. Hafiz, a foreign exchange trader at Citigroup, can invest $3 million, or the foreign currency equivalent of the bank's short term funds, in a covered interest arbitrage with Norway. Hafiz is faced with the following market quotes and wonders if he could make covered interest arbitrage (CIA) profit?

Assumptions	Value
Arbitrage funds available	$3,000,000
Spot exchange rate (Nok/$)	6.0312
3-month forward rate (Nok/$)	6.0186
US dollar 3-month interest rate	5.000%
Norwegian krone 3-month interest rate	4.450%

(12 marks)

b. Assuming the following quotes, illustrate how a market trader at Goldman Sachs with $1,000,000 can make an intermarket arbitrage profit. Support your answers with computation.

Goldman Sachs quotes U.S. dollar per pound:	$1.5800/£
Barclays quotes euros per pound:	€1.2100/£
Bank of America quotes U.S. dollar per euro:	$0.7650/€

Assumptions	Exchange rate
Goldman Sachs quote: US$/pound ($/£)	1.5800
Barclays quote: euros/pound (€/£)	1.2100
Bank of America quote: US$/euro ($/€)	0.7650
Initial investment	$1,000,000.00

(8 marks)

(Total: 20 marks)

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QUESTION 4

a. Headquartered in New York, VNBC Co. is the one of the largest specialty goods company to have its U.S. business funded with dollars and a capital structure of 70% debt and 30% equity. It has its China business funded with Chinese Yuan with a total debt of Chinese Yuan 80 million. This debt represents 25% of its total capital in China and its effective tax shield is 40%. The risk-free rate in US$ is 2.75% while in Chinese Yuan is 1.05%. VNBC's equity portfolio beta is 1.15. The market risk premium is 5%. China has an inflation rate of 8% while it is 4.5% in the U.S.

Based on the information above, estimate the weighted average cost of capital (WACC) for VNBC's subsidiary in China. (6 marks)

b. Explain the term "Market Segmentation". Discuss **TWO (2)** causes of Market Segmentation.

(6 marks)

c. The cost of capital for MNCs may differ from domestic firms. Briefly discuss **FOUR (4)** reasons.

(8 marks)

(Total: 20 marks)

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